Supreme Court, U.S.
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No. 86-489

In the Supreme Court of the United States

OCTOBER TERM, 1986

W.T. LANGLEY AND MARY ANN GRIMES LANGLEY,
Petitioners

v.

FEDERAL DEPOSIT INSURANCE CORPORATION
Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR PETITIONERS ON THE MERITS

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PETITION FOR A WRIT OF CERTIORARI FILED ON SEPTEMBER 23, 1986
WRIT OF CERTIORARI GRANTED ON JANUARY 12, 1987

QUESTIONS PRESENTED

I. Whether the statutory language of 12 U.S.C. 1823(e) barring oral agreements between an obligor and a failed bank from being asserted as a defense against a suit on a promissory note by the Federal Deposit Insurance Corporation encompasses situations where the makers of the note assert that officers of the failed bank made factual misrepresentations which induced them to execute the note.

II. Whether federal common law provides further protection to the Federal Deposit Insurance Corporation from defenses raised by makers of notes acquired by the Federal Deposit Insurance Corporation from a failed bank beyond the statutory protection provided by 12 U.S.C. 1823(e).

PARTIES TO THE PROCEEDINGS

Federal Deposit Insurance Corporation (as successor to Planters Trust and Savings Bank)

W. T. Langley

Mary Ann Grimes Langley

Roy E. Caughfield

Federal Land Bank of Jackson

Elmer Landry

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PETITIONERS

versus

FEDERAL DEPOSIT INSURANCE CORPORATION,
RESPONDENT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR PETITIONERS ON THE MERITS

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 792 F.2d 541 (5th Cir. 1986) and is reprinted in the original Petition For a Writ of Certiorari as Appendix A, pp. A1-A18. The opinion of the District Court granting respondent's motion for summary judgment is reported at 615 F. Supp. 749 (W. D. La. 1985) and is reprinted in the original Petition For a Writ of Certiorari as Appendix B, pp. A19-A25.

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JURISDICTIONAL STATEMENT

The judgment of the Court of Appeals was entered on June 24, 1986. The petition for a writ of certiorari was filed on September 23, 1986. The petition was granted on January 12, 1987. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. 1254(1).

STATUTE INVOLVED

This case involves the interpretation of § 2(13)(3) of the Federal Deposit Insurance Act of 1950, as amended, codified as 12 U.S.C. 1823(e) as follows:

> "No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank."

STATEMENT OF THE CASE

On October 3, 1980, a purchase agreement was entered into by W. T. Langley, a resident of Blytheville, Arkansas, and Leenerts Farms, Inc. ("Leenerts") for a farm containing "a total of 1,600 acres, more or less" in Pointe Coupee Parish, Louisiana, (hereinafter the "Melville Property"). The actual acquisition of the Melville property occurred on December 19, 1980. Financing for the purchase was provided to the Langleys by the Federal Land Bank in the amount of $1,350,000.00, secured by a first mortgage on the property and by Planters Trust and Savings Bank ("Planters") in the amount of $450,000.00, secured by a second mortgage in the amount of $500,000.00 on the property. The balance owed on the Planters note, including interest, was renewed on January 27, 1982 and again on March 8, 1982. This latter note was sued upon by Planters in Louisiana state court in September, 1983. (J.A. p. 35.) The Langleys removed this action to the United States District Court for the Western District of Louisiana on the basis of diversity jurisdiction. On

October 18, 1983, the Langleys filed a complaint in the United States District Court for the Middle District of Louisiana, alleging a right to affirmative recovery from Planters and the other defendants therein in excess of $5,000,000.00. (J.A. pp. 46-57.) Subsequently, both actions were consolidated in the Western District of Louisiana. On October 5, 1984, four months after Planters was declared to be in an unsafe and unsound condition, the FDIC was substituted as a party plantiff in these consolidated proceedings. On June 10, 1985, the FDIC in its capacity as receiver of Planters was substituted as a party defendant in the action filed by the Langleys. As the holder of the Langleys' note to Planters, the FDIC then moved for summary judgment. (J.A. p. 122.) As a defense against the claims on the promissory notes by Planters and the Federal Land Bank ("FLB"), the Langleys allege in their action for affirmative recovery that Elmer Landry (formerly President of the Federal Land Bank Association of Opelousas) and Roy Caughfield (formerly President of Planters), both of whom are defendants in the District Court, fraudulently induced the Langleys to sign the Planters note and all preceding notes by certain statements, claims, representations, inducements, and omissions knowingly made by Caughfield and Landry, individually and on behalf of Planters and the FLB, respectively. The Langleys allege that but for these misrepresentations, inducements, and omissions by Caughfield and Landry, individually and on behalf of Planters and the FLB, respectively, they would not have purchased the Melville property and signed the promissory notes herein sought to be enforced. (J.A. p. 50.) Thus, the Langleys seek a declaration that the promissory notes and mortgages of Planters and the FLB are unenforceable, null and void for failure or want of cause and, alternatively, for error occurring as a result of the fraudulent misrepresentations, inducements, and omissions of the defendants or, in the further alternative, limiting enforcement of the notes and mortgages to the property itself.

Specifically, the Langleys allege that:

1) Rather than the 1,628.4 acres represented orally, in the sale itself, and on a map prepared by or on behalf of the FLB, the Melville property consists of only 1,522 acres;
2) Rather than receiving 400 mineral acres as was orally represented to the Langleys, only approximately 75 mineral acres were transferred;

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3) Caughfield, individually and on behalf of Planters, represented that no outstanding mineral leases burdened the property when in truth and fact, there existed an outstanding mineral lease held by Chevron, U.S.A. and, furthermore, the executive rights were held by another third party, John Barton; and

4) The defendants engaged in a pattern of racketeering activity reprobated by 18 U.S.C. 1961, et seq., in that they have repeatedly used the United States mails and other interstate communications to further their fraudulent scheme which was designed to induce the Langleys to purchase the Melville property in order to rescue Planters from loans made to the prior owners of the Melville property which were in default (and who went bankrupt 3 months after the purchase), and to generate certain "fees" and "commissions" for Landry and Caughfield. (J.A. p. 53.)

In answers to interrogatories, the Langleys have further asserted that Caughfield, individually and on behalf of Planters, made verbal representations in the presence of witnesses, on five or six occasions, that Leenerts owned 1,628.4 surface acres and 400 mineral acres that would be conveyed to the Langleys. (J.A. pp. 104-106.) The purchase agreement and the sale stated that 1,628.4 total acres were to be conveyed along with one-half of the mineral rights owned by Leenerts. (J.A. pp. 16, 17, 19.)

On May 18, 1984, *seven months after the Langleys instituted their suit against Planters*, the Commissioner of Financial Institutions for the State of Louisiana declared Planters to be in an unsafe and unsound condition, closed Planters and took possession of its books, property, and affairs. (J.A. p. 91.) The Commissioner appointed the Federal Deposit Insurance Corporation (in its receivership capacity, the "FDIC") as receiver and liquidator thereof and the FDIC accepted such appointment. (J.A. p. 92.) Pursuant to LSA-R.S. 6:457, upon the acceptance by the FDIC of its appointment as receiver and liquidator, the possession of and title to all of the assets, business, and property of the banking institution, of every kind and nature, passed to and vested in the FDIC as receiver without the execution of any instruments of conveyance, assignment, transfer or endorsement. Subsequently on May 18, 1984, pursuant to an order of the Twenty-Seventh Judicial District Court for the Parish of St. Landry, State of Louisiana, the FDIC in its corporate capacity ac-

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quired all of the assets of Planters, including the assets which are the subject of this suit, in a "purchase and assumption" transaction.

As early as April 6, 1984, *the FDIC had actual knowledge of the Langleys' claims* that the property purchased was not as represented to be and that the Langleys had sued Planters Bank. (J.A. pp. 63, 66.)

The District Court granted the FDIC's motion for summary judgment on the basis that 12 U.S.C. 1823(e) shields the FDIC from the affirmative defenses of the Langleys on the Planters note. The District Court noted, however, that there is authority for the Langleys' proposition that § 1823(e) does not encompass situations where the maker of a note asserts fraud in the inducement of the underlying obligation. (P. p. A-23.) The District Court also noted that there was no clear controlling precedent from the Fifth Circuit on this issue. Given the importance of a clear precedent on this issue and the possibility that district courts in the Fifth Circuit will be faced with similar issues arising out of the collapse of Planters and other banks, the Langleys appealed.

The Fifth Circuit affirmed the District Court's judgment on the basis of § 1823(e) holding that the Langleys are attempting to assert a part of their total side agreement with Planters to vary the terms of their loan. (P. p. A-16.) While it is true that the Langleys alleged in their complaint for affirmative recovery that both factual misrepresentations and promissory misrepresentations were made by Planters and that the latter may be construed as "agreements", the lower court is simply incorrect in asserting that the Langleys are attempting to rely on promissory misrepresentations to vary or add terms to the loan documents they executed. (P. p. A-16.) Rather, the promissory misrepresentations were made by Planters in conjunction with a fraudulent scheme to induce the Langleys to enter into a loan agreement with Planters. The Langleys contend that no agreement existed because of the factual misrepresentations. The Langleys have never attempted to assert the promises by Planters regarding the terms of the loan as valid against the FDIC. In fact, the lower court does not explicitly reject the distinction between factual fraud and promissory fraud in the the application of § 1823(e) which has been recognized by other courts. (P. p. A-15 n. 5.)

SUMMARY OF ARGUMENT

The Langleys contend that the statutory language of 12 U.S.C. 1823(e), which bars oral agreements between an obligor and a failed bank from being asserted as a defense against a suit on a promissory note acquired by the FDIC, does not encompass the situation where the makers of the note assert that factual fraud committed by a bank's officers induced the underlying obligation. The statutory language of § 1823(e) applies specifically to an "agreement which tends to diminish or defeat" the FDIC's right to collect an asset acquired from a failed bank. Thus, case law interpreting the statute has distinguished between two types of fraud in the inducement in determining whether that section is applicable. One type is an oral promise by a bank to perform a duty in connection with the execution of a note that it does not intend to perform. An example of such fraud in the inducement is a promise by the bank that the makers will not have to make any payments on the loan until the property securing the loan is sold by the makers. Another type of fraud in the inducement is a knowing misrepresentation made by the bank, not involving any promise, to induce a party to execute a promissory note. An example of such fraud in the inducement is a misrepresentation made by a bank that a given company is in sound financial condition in order to induce a party to borrow money to purchase stock in the company.

The Langleys' claims fall into the latter type of fraudulent inducement as several of the misrepresentations and omissions made by Planters and alleged in the Langleys' original complaint are not agreements of any sort. Rather, the Langleys assert that because of the factual misrepresentations made to them and the fraud practiced upon them, their consent to the transaction was not lawfully given. Without consent lawfully given, there is no consent and without consent there is no agreement. If there is no agreement, § 1823(e), by its own terms, does not apply.

In 1950, Congress codified the holding of *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 62 S.Ct. 676, 86 L.Ed. 956 (1942) into § 1823(e). This Court has held that when Congress addresses a question previously governed by a decision rested on federal common law, the need to rely on federal common law to decide a case disappears. Congress has now spoken directly to the question of the protection of the FDIC from defenses raised by obligors of notes which are acquired by the FDIC from failed banks. Consequently, the

enactment of § 1823(e) has preempted the federal common law arising out of the *D'Oench* case.

Therefore, the FDIC is not entitled to a summary judgment against the Langleys on the Planters note. The present judgment must be reversed and this case must be remanded to the District Court for a trial on the merits.

ARGUMENT

I. *12 U.S.C. 1823(e) DOES NOT APPLY WHEN A BANK'S FACTUAL MISREPRESENTATIONS INDUCE A BORROWER TO EXECUTE A PROMISSORY NOTE*

When the FDIC acquires the assets and liabilities of a failed bank in a purchase and assumption transaction, it is entitled to the statutory protection of 12 U.S.C. 1823(e) against "agreement(s)" between the failed bank and obligors of notes owned by the failed bank which would diminish or defeat the right of the FDIC to enforce the obligations owned by the failed bank. The rule of § 1823(e) is derived from the case of *D'Oench, Duhme, & Co. v. FDIC*, 315 U.S. 447, 62 S.Ct. 676, 86 L.Ed. 956 (1942) which holds that federal law controls the rights and obligations of the FDIC.

12 U.S.C. 1823(e) provides:

> "No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank."

§ 1823(e) by its terms protects the FDIC only from "agreement(s)" not satisfying the section's requirement. In *Gunter v. Hutcheson*, 674 F.2d 862 (11th Cir. 1982), *cert. denied*, 459 U.S. 826, 103 S.Ct. 60, 74 L.Ed.2d 63 (1982), and *FDIC v. Hatmaker*, 756 F.2d 34 (6th Cir. 1985), the Eleventh and Sixth Circuits have adopted an interpretation of § 1823(e) which distinguishes between

two types of fraud in the inducement in determining whether that section is applicable. One type is an oral promise by the bank to perform a duty in connection with the execution of a note that it does not intend to perform. An example of such fraud in the inducement is a promise by the bank that the makers will not have to make any payments on the loan until the property securing the loan is sold by the makers. Another type of fraud in the inducement is a knowing misrepresentation made by the bank, not involving any promise, to induce a party to execute a promissory note. An example of such fraud in the inducement is a representation made by a bank that a given company is in sound financial condition in order to induce a party to borrow money to purchase stock in the company.

In the latter type of fraud in the inducement, there is no "agreement" between the parties; rather, a material misrepresentation regarding the subject matter of the loan fraudulently induces the borrower's consent to the transaction. The Langleys claim that the representations made to them regarding the nature of the property purchased are so material to their consent that the proven falsity of these representations by an officer of the failed bank will negate the entire transaction. Thus, rather than attempting to hold a side agreement with the failed Planters Bank valid, the Langleys seek to prove that there was never an agreement at all because their consent was unlawfully obtained. Under Louisiana law, without valid consent there can be no agreement. Louisiana Revised Civil Code (former) Articles 1779, 1819 and 1824. As a result, § 1823(e) is not applicable to this case. § 1823(e) by its explicit language applies only to an "agreement" between a bank customer and the failed bank.

In *Gunter*, supra, the makers of a promissory note in favor of a failed bank brought suit against the failed bank, after it failed, and some of its officers and the FDIC. The FDIC had entered into a purchase and assumption agreement by which the FDIC purchased the note from another bank to which all of the failed bank's assets had been transferred. The makers of the note sought rescission of the note against the FDIC asserting the violation of various securities laws and fraud as a result of actions taken by officers of the failed bank. Specifically, the makers alleged that in connection with the purchase of bank stock, the chairman of the board fraudulently represented that the bank was in "sound financial condition." The FDIC moved for summary judgment on the basis that it was protected against the customer's fraud claims by § 1823(e) or under federal common law.

The Eleventh Circuit Court of Appeals held that the claims by the makers of the note held by the FDIC were not barred by the statutory language in § 1823(e). 674 F.2d at 867.

The *Gunter* Court analyzed several decisions of the Fifth Circuit which all held that § 1823(e) shielded the FDIC from the defenses raised by the borrowers in those cases.

In *Black v. FDIC*, 640 F.2d 699 (5th Cir. 1981), *cert. denied*, 454 U.S. 838, 102 S. Ct. 143, 70 L. Ed. 2d 119 (1981), an obligor attempted to prove that a real estate development loan agreement with a bank included the unwritten understanding to make construction loans on certain real estate. The Court held that the statutory protection of § 1823(e) shielded the FDIC from assertion of the alleged oral side agreements against an insolvent bank. 640 F.2d at 701. In *FDIC v. Hoover Morris Enterprises*, 642 F.2d 785 (5th Cir. 1981), the obligor contended that a bank had agreed to take a deed in satisfaction of the debt sued upon. The court held that the agreement could not be asserted against the FDIC under § 1823(e). 642 F.2d at 787. In *Chatham Ventures, Inc. v. FDIC*, 651 F.2d 355 (5th Cir. 1981), *cert. denied*, 454 U.S. 1126, 102 S. Ct. 975, the obligors claimed that the bank breached a joint venture agreement to advance further funds for development expenses for certain real estate. The Court held that the alleged oral joint venture agreement failed to meet the statutory writing requirement of § 1823(e) for such an agreement to be assertable against the FDIC. 651 F.2d at 362. In *FDIC v. Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981), the obligor asserted that the bank breached an alleged promise to make future loans to develop real estate. The court held that § 1823(e) shielded the FDIC from this unwritten side agreement. 656 F.2d at 142. Undoubtably, the FDIC can cite many other cases with similar factual circumstances where § 1823(e) has been applied to shield the FDIC; however, *the statute does not say that the FDIC always wins*.

With regard to the above-noted cases, the *Gunter* court reasoned:

> "The common thread running through these cases had been the assertion by the obligor that an oral side agreement with the bank controlled the rights of the parties. The cases, therefore, came squarely within the 'no agreement . . . shall be valid' language of § 1823(e)." 674 F.2d at 867.

The *Gunter* court went on to point out the difference between those cases and the case at bar:

"The claim asserted by the Gunters, in contrast, is quite different. The essence of their argument is that no agreement existed because of the fraud of (the failed bank's) officers. While certain of the alleged misrepresentations could be construed as 'agreements' to perform certain acts in the future, such as deferring interest on the Gunters' notes, others clearly are not agreements of any sort . . . Far from claiming that an oral agreement is 'valid' and controls the rights of the parties, the Gunters assert that the entire transaction was invalid from the beginning. As the district court noted, this claim is directly opposite to the 'shall be valid' language of § 1823(e). Consequently, we agree with the trial court that the fraud claims at issue here are not barred by the statutory language in § 1823." 674 F.2d at 867.

The *Gunter* rationale has been approved by the Sixth Circuit Court of Appeals in the recent case of *Hatmaker*, supra, where the Court stated:

"Under § 1823(e), the case law has distinguished between two types of fraud in the inducement in determining whether that section is applicable. *Gunter v. Hutcheson*, 674 F.2d 862, 867 (11th Cir. 1982), *cert. denied*, 459 U.S. 826, 103 S. Ct. 60, 74 L. Ed. 2d 63 (1982). One type of fraud in the inducement is an oral promise by the bank to perform a duty in connection with the execution of a note that the bank does not intend to perform. An example of such fraud in the inducement is a promise by the bank to make future loans to the borrower which the bank does not plan to perform. See *FDIC v. Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981). Another type of fraud in the inducement is a misrepresentation made by the bank, not involving any promise, to induce a party to execute a promissory note. A good example of such fraud in the inducement is a misrepresentation by the bank that it is in sound financial condition in order to induce a party to borrow money to purchase its stock. *Gunter*, 674 F.2d at 867.

In the second type of fraud in the inducement, no side agreement exists between the parties, and § 1823(e) cannot be applicable. In the first case, however, a side agreement is present to which § 1823 can be applied. Although that side agreement may have been fraudulently induced, it is still a separate agreement into which the parties voluntarily entered." 756 F.2d at 36-37.

Further support for this distinction is found in the case of *In Re Longhorn Securities Litigation*, 573 F. Supp. 278 (W. D. Okla.

1983), where the court noted that both linguistically and legally, a representation is not an agreement. 573 F.Supp. at 282. *Black's Law Dictionary* defines a representation as a "(s)tatement of fact made to induce another to enter into a contract," *Black's Law Dictionary* (5th Ed. 1979), p. 1169, whereas an agreement is defined as "a concord of understanding and intention between two or more parties with respect to the effect upon their relative rights and duties, of certain past or future facts or performances." *Webster's* defines a representation as "a statement or account, especially made to convey a particular view or impression of something with the intention of influencing opinion or action," *Webster's Third New International Dictionary* (1981), p. 1926, whereas an agreement is defined as "the act of agreeing or coming into a mutual arrangement."

Clearly, an intentional misstatement of fact by a bank officer which serves to fraudulently induce a borrower's consent to a transaction involving the bank is not an "agreement" with the bank which causes the bank's assets to be overstated; rather, the bank has deceived the borrower for the purpose of acquiring an asset. The assertion that factual misrepresentation diminishes or defeats the right, title or interest of the FDIC in the asset after the bank fails is not equivalent to the assertion of an "agreement". Since an agreement is by definition an accord of understanding and intention between two parties, if a party's understanding is premised upon untrue facts, the truth being known only by one party, then the other party's consent to an agreement premised upon misrepresented facts is not based on the common knowledge and intention of the parties and, therefore, cannot be an agreement. The assertion that factual misrepresentation invalidates a borrower's consent to a transaction involving an insured bank does not assert as "valid" against the FDIC an "agreement" that is reprobated by § 1823(e).

We must assume that the legislative purpose of the statute is expressed by the ordinary meaning of the words used. *U. S. v. Locke*, 471 U.S. 84, 105 S.Ct. 1785, 85 L.Ed.2d 64 (1985). There is no ambiguity in the meaning of the words of § 1823(e). When the terms of a statute are unambiguous, judicial inquiry is complete, except in rare and exceptional circumstances. *Rubin v. U.S.*, 449 U.S. 424, 430, 101 S.Ct. 698, 701, 66 L.Ed.2d 633 (1981); *Crooks v. Harrelson*, 282 U.S. 55, 60, 51 S.Ct. 49, 50, 75 L.Ed. 156 (1930). Where the meaning of the statute is clear, it must be enforced as written. *McFeely v. Commissioner*, 296 U.S. 102, 111, 56 S.Ct. 54, 80 L.Ed.

83, 90 (1935); *U. S. v. Martin*, 337 F.2d 171, 174 (8th Cir. 1964); *Hilliard v. U.S.*, 310 F.2d 631, 632 (6th Cir. 1962). The Langleys ask no more and no less.

In the instant case, the Langleys do in fact assert that there were promissory misrepresentations concerning repayment of the note. (J.A. p. 50.) The Langleys concede that the shield of § 1823(e) protects the FDIC against their claims that the transaction should be rescinded as a result of representations made by Roy Caughfield, President of Planters, that the Langleys would have no personal liability on the notes, that the Langleys would not be required to make any payments on the subject loan until the property was sold and that the interest rate on the loan would be two (2%) percent above the prime rate of Chase Manhattan Bank. However, other misrepresentations alleged by the Langleys are clearly not agreements of any sort. For example, the Langleys allege in Paragraph 23 of their original Complaint that the defendants represented that no outstanding mineral leases burdened the property when in truth and in fact there existed an outstanding mineral lease and, furthermore, the executive rights were held by another third party, John Barton. (J.A. p. 51.) Also, according to the answers to interrogatories, Landry and Caughfield claimed that the land included within its boundaries a certain number of surface acres and that the Langleys would obtain a certain percentage of mineral rights in the land. (J.A. pp. 100, 104, 105, 106.) It is also alleged in the original Complaint that representations were made or facts were omitted by the defendants with the intention of convincing the Langleys to purchase property without being possessed of all the facts which defendants knew would be necessary for the Langleys to consider in order to make an informed decision regarding the purchase of the property and the terms thereof. (J.A. p. 50.) The Langleys have alleged in pleadings and have sworn in their answers to interrogatories that these representations were made. These are not claims of agreements; these are claims of representations. The Langleys are not attempting to hold any side agreement with the failed Planters Bank valid; rather, the Langleys' claims made in the original and amended Complaints, if proven, negate the entire transaction. § 1823(e), essentially a statute of frauds enacted for the benefit of the FDIC, does not bar claims of fraud.

Seizing on the fact that the Langleys have conceded that § 1823(e) protects the FDIC from the promissory misrepresentations made by Planters regarding the terms of the Planters loan and repayment of the

note, the lower court held that the Langleys are attempting to assert a part of their total side agreement to vary the terms of the loan. (P. p. A-16.) The Fifth Circuit Court of Appeals effectively held that if one of the defenses a party has cannot be asserted against a party, then none of that party's defenses can be asserted. How can the rejection of one defense automatically require the rejection of another?

The Fifth Circuit has apparently inferred that the Langleys did not rely on the factual misrepresentations in light of their admitted reliance on collateral oral agreements as well. The question of reliance can only be determined after trial on the merits.[1] The Langleys contend that for purposes of the applicability of § 1823(e), the only relevant allegations are their claims of misrepresentations and fraud concerning the characteristics of the property which they purchased. The Langleys filed suit against Planters and other defendants approximately seven (7) months prior to the failure of Planters at a time

[1]Summary judgment should be entered only if "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law". Fed.R.Civ.P. 56(c). See *Adickes v. S. H. Kress & Company*, 398 U.S. 144, 157, 90 S.Ct. 1598, 1608, 26 L.Ed.2d 142 (1970). The mover has the burden of showing the absence of a genuine issue as to any material fact and inferences to be drawn from underlying facts contained in the moving party's materials must be viewed in the light most favorable to the party opposing the motion. *Ibid.* It is not the judge's function to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial. *Anderson v. Liberty Lobby, Inc.*, ____ *U.S.* ____, *106 S.Ct. 2505, 2511 (1986)*. There is no issue for trial unless there is sufficient evidence favoring the non-moving party for a jury to return a verdict for that party. *First National Bank of Arizona v. Cities Service Co.*, 391 U.S. 253, 288-289, 88 S.Ct. 1575, 1592, 20 L.Ed.2d 569 (1968). Summary judgment may be inappropriate even where the parties agree on the basic facts, but disagree about the factual inferences that should be drawn from these facts. *Lighting Fixture & Electric Supply Co. v. Continental Insurance Company*, 420 F.2d. 1211, 1213 (5th Cir. 1969). If reasonable minds might differ on the inferences arising from undisputed facts, then the court should deny summary judgment. *Croley v. Matson Navigation Co.*, 434 F.2d 73, 75 (5th Cir. 1970).

When the factual issues have not been tried, appellate review of the District Court's judgment is under the rigid standards attendant upon the entry of summary judgment under Rule 56 of the Federal Rules of Civil Procedure rather than under the "clearly erroneous" doctrine of Rule 52(a), Fed.R.Civ.P. *McAllister v. United States*, 348 U.S. 19, 75 S.Ct. 6, 99 L.Ed. 20 (1954). This case having been decided upon a motion for summary judgment by the FDIC, these rules must be kept in mind in considering the correctness of the result.

when the misrepresentations concerning the terms of the loan were assertable against the Bank. The fact that the misrepresentations concerning the terms of the loan appear as allegations in the Langleys' suit, but are not assertable against the FDIC after the failure of Planters, does not mean that the Langleys are attempting to assert them as valid against the FDIC in violation of § 1823(e). Rather, the alleged factual misrepresentations are independently sufficient to invalidate the Langleys' consent to the transaction. There never was an agreement because the Langleys' consent was based on misrepresented facts. The Langleys could not anticipate that the FDIC would become a party to their suit. Further, there are other parties defendant who do not enjoy the statutory protection available to the FDIC. It is to these defendants that the other allegations of the Langleys' complaint must be directed. Indeed, the Langleys have asserted that the conduct of the defendants in this case is reprobated under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. 1961, et seq. (J.A. p. 53.)

The distinction between factual misrepresentations and promissory misrepresentations recognized by the Eleventh and Sixth Circuits is based upon the plain meaning of the text of the statute; it will not lead to absurd results or thwart the purpose of the statute. *In Re Trans Alaska Pipeline Rate Cases,* 436 U.S. 631, 643, 98 S.Ct. 2053, 2061, 56 L.Ed.2d 591 (1978). Congress clearly did not intend anything less than an agreement between the obligor and the bank to be barred by law as against the FDIC. In situations where factual misrepresentation precludes an agreement between the borrower and the bank, the fact that the bank's asset is saddled with unknown defects is due solely to the fraud of the bank officer committed upon an innocent borrower. The absurdity of applying the bar of § 1823(e) in this situation is revealed. Congress obviously did not intend that bank officers be licensed to commit fraud in acquiring assets for the bank and then prevent innocent borrowers from asserting the fraud practiced by bank officers as against the FDIC after the bank fails. Such a rule places an unwarranted burden on a borrower who happens to borrow money from a bank that fails. Further, such a rule is clearly not justified by the plain wording of § 1823(e).

The Langleys' theory of fraudulent inducement as a result of the aforesaid factual misrepresentations is simply not a doctrine based on the parties' mutual assent. The Langleys contend that the Planters note is invalid and that such invalidity is caused by representations

intended to deceive the borrowers into executing the note. These false representations amount to factual fraud and are not barred by § 1823(e) from being asserted against the FDIC.

II. *APPLICATION OF FEDERAL COMMON LAW IS PREEMPTED BY SECTION 1823(e)*

The FDIC is expected to vigorously contend that federal common law affords a shield to it against the claims of borrowers such as the Langleys and, further, that this shield is separate and distinct from the protections afforded the FDIC under § 1823(e). As will become apparent hereafter, the federal common law rule of *D'Oench, Duhme & Co. v FDIC*, supra, has not survived the enactment of § 1823(e).

As this Court has previously held, federal courts, unlike state courts, are not general common law courts and do not possess a general power to develop and apply their own rules of decision. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78, 58 S.Ct. 817, 822, 82 L.Ed. 1188 (1938); *United States v. Hudson and Godwin*, 7 Cranch 32, 3 L.Ed. 259 (1812); *City of Milwaukee v. Illinois and Michigan*, 451 U.S. 304, 101 S.Ct. 1784, 68 L.Ed.2d 369 (1981). The federal judiciary is generally not charged with responsibility for the enactment of a federal rule in an area of national concern, thereby displacing state law in doing so. This function is reserved to Congress, which is composed of the elected representatives of the people. *Wallis v. Pan American Petroleum Corp.*, 384 U.S. 63, 68, 86 S.Ct. 1301, 1304, 16 L.Ed.2d 369 (1966). In *City of Milwaukee*, this Court recognized the coexistent responsibilities of Congress and the federal judiciary in ruling that a federal court could not generally apply a federal rule of decision in the absence of an applicable act of Congress. 451 U.S. at 313, 101 S.Ct. at 1790.

Despite its earlier pronouncements in *Erie*, this Court has in some circumstances found it necessary to assume a lawmaking function. In a "few and restricted" instances, this Court has found it necessary to develop federal common law. *Wheeldin v. Wheeler*, 373 U.S. 647, 651, 83 S.Ct. 1441, 1445, 10 L.Ed.2d 605 (1963). The development of federal common law is confined to those circumstances where (1) Congress has not spoken to a particular issue; and (2) where there exists a "significant conflict between some federal policy or interest and the use of state law," *Wallis*, supra at 68, 86 S.Ct. at 1304. See, e.g. *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367, 63 S.Ct. 573, 575, 87 L.Ed. 838 (1943).

In *D'Oench, Duhme & Co. v. FDIC*, supra, this Court, faced in 1942 with a circumstance in which there was no positive statutory law regarding the bank customer's civil liability, fashioned a rule of federal common law, holding that the maker of a note was estopped as against the FDIC from enforcing a secret agreement (written on a receipt but not on the notes themselves) that the notes would never be repaid. 315 U.S. at 460, 62 S.Ct. at 681. In so doing, the Court pointed out the existence of a federal policy designed to protect the FDIC and the public funds which it administers against misrepresentation as to the security held in the portfolio of banks insured by the FDIC. 315 U.S. at 457, 62 S.Ct. at 679. This federal policy was gleaned from § 12B(s) of the Federal Reserve Act, 12 U.S.C. 264(s) as it then existed. § 12B(s) was a criminal statute and did not purport to regulate the civil liability of the bank's customer. There was simply no statute on point at that time. Congress enacted the Federal Deposit Insurance Act of 1950, which included 12 U.S.C. 1823(e) in its original form. We now have a statute which regulates the civil liability of customers of failed banks. Federal common law has been supplanted.

This Court has long recognized that the federal common law is "subject to the paramount authority of Congress." *City of Milwaukee v. Illinois and Michigan*, supra, 451 U.S. at 313; 101 S.Ct. at 1791; *New Jersey v. New York*, 283 U.S. 336, 348, 51 S.Ct. 478, 481, 75 L.Ed. 1104 (1931); *Northwest Airlines v. Transport Workers Union*, 451 U.S. 77, 101 S.Ct. 1571, 67 L.Ed.2d 750 (1981). Federal common law is only resorted to "(i)n the absence of an applicable act of Congress." *Clearfield Trust*, supra at 367, 63 S.Ct. at 575. The *D'Oench* court recognized that the court is compelled to consider federal questions "which cannot be answered from the federal statutes alone." *D'Oench*, supra, 315 U.S. at 469, 62 S.Ct. at 684. (Jackson, J., concurring). When Congress addresses a question previously governed by a decision rested on federal common law, the need for such an extraordinary exercise of lawmaking authority by a federal court disappears. *Northwest Airlines*, supra, 451 U.S. at 94, 101 S.Ct. at 1583; *Illinois v. Milwaukee*, 406 U.S. 91, 107, 92 S.Ct. 1385, 1394, 31 L.Ed.2d 712 (1972); *City of Milwaukee v. Illinois and Michigan*, 451 U.S. at 314, 101 S.Ct. at 1791. This point was dramatically recognized in *Illinois v. Milwaukee* itself, 406 U.S. at 107, 92 S.Ct. at 1394 ("New federal laws and new federal regulations may in time preempt the field of the federal common law of

nuisance."), in *Arizona v. California*, 373 U.S. 546, 83 S.Ct. 1468, 10 L.Ed.2d 542 (1963) wherein the Court declined to apply the federal common law doctrine of equitable apportionment it had previously developed and in *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 98 S.Ct. 2010, 56 L.Ed.2d 581 (1978) wherein this Court refused to provide damages for "loss of society" under the general maritime law since Congress had not provided such damages under the Death on the High Seas Act.

A review of these decisions leads one to conclude that the operative question is whether or not the legislative scheme "spoke directly to a question" and not whether Congress had affirmatively proscribed the use of federal common law. In the present case, Congress has spoken directly to the question at hand. Congress has, in § 1823(e), enacted a statute regulating the circumstances in which the defenses of a borrower against a failed bank may be asserted against the FDIC. The commitment to the separation of powers is too fundamental to continue to rely on federal common law by judicially decreeing what accords with "common sense and the public weal" when Congress has addressed the problem. *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 194, 98 S.Ct. 2279, 2301, 57 L.Ed.2d 117 (1978). "There is a basic difference between filling a gap left by Congress' silence [as was done in 1942 by the *D'Oench* court] and rewriting rules that Congress has affirmatively and specifically enacted." (As the FDIC seeks in the case at bar). *Mobil Oil Corp.*, 436 U.S. at 625, 98 S.Ct. at 2015, 56 L.Ed.2d at 581. Deference to the supremacy of the legislature, as well as recognition that Congressmen typically vote on the language of a bill, generally requires us to assume that the legislative purpose is expressed by the ordinary meaning of the words used. *Richards v. United States*, 361 U.S. 1, 9, 82 S.Ct. 585, 591, 7 L.Ed.2d 492 (1962); *United States v. Locke*, supra, 105 S.Ct. at 1793.

The FDIC was established under authority of Section 8 of the Banking Act of 1933, and Section 101 of the Banking Act of 1935 which provided the permanent plan of deposit insurance contained in existing law. As noted above, prior to 1950, no statute regulated the situation where a bank customer entered into a secret agreement with a bank that served to misrepresent the bank's assets to the FDIC. The Federal Deposit Insurance Act of 1950 represents a rather comprehensive revision of the prior law. The principal changes made by the Act were:

"... (a) the increase in the insurance coverage from $5,000 to $10,000; (b) the simplification in the computation of the assessment base; (c) the reduction in years in which the Corporation does not encounter undue losses, in the cost of deposit insurance to the banks by making provision for a credit to them of a percentage of the net assessment paid each year; (d) the expansion of examination authority to enable the Corporation to examine any insured bank or any bank seeking insurance; and (e) the payment to the Treasury of interest at 2 percent on capital funds originally provided by the Treasury and the Federal Reserve banks. . . ." 1950 U.S. Code Cong. Service, p. 3767.

Although there is no clear indication in the legislative history, one must assume that the enactment of § 1823(e) was intended to address the gap in the law which was noted in *D'Oench*. The statute specifically enumerates the conditions which must be satisfied in order for an agreement between an obligor and a bank, which may affect the value of a bank asset, to be asserted as valid against the FDIC. Congress has now spoken directly to the question of the protection enjoyed by the FDIC in the situation where an agreement between an obligor and a failed bank may affect the value of a bank asset. Certainly, the statute does not address every situation which may affect the value of bank assets when the FDIC seeks to collect them, but when the statute does speak directly to a question, the courts are not free to supplement Congress' answer so that the meaning and intent of the statute is ignored. *Mobil Oil Corp. v. Higginbotham*, supra at 625, 98 S.Ct. at 2015. One cannot ignore the meaning of the key word in the statute - "agreement". As noted above, Congress obviously intended that nothing less than an agreement between an obligor and a bank should be barred by law as against the FDIC if the statute's requirements are not satisfied. Before hastening to "fill a gap" in the statute relating to factual misrepresentations by a bank which induce a borrower to execute a note by the use of federal common law, this Court must consider whether it would be providing a different rule to shield the FDIC from borrower defenses based upon its own judgment of what the rule should be. *City of Milwaukee v. Illinois*, supra at 324, n. 18, 101 S.Ct. at 1796 n. 18. Commendably, the lower court in this case declined to take this additional step. (P. p. A-15, n. 5).

For the foregoing reasons, the FDIC may not claim additional protection from borrower defenses under federal common law.

CONCLUSION

Fraudulent and knowing misrepresentations made by a bank to induce a party to execute a promissory note are not within the ambit of 12 U.S.C. 1823(e) because such misrepresentations are not "agreements" which tend to diminish or defeat the right, title, or interest of the FDIC in an asset acquired from a failed bank. Certain allegations made by the Langleys in their original complaint are not in the nature of agreements which are sought to be asserted against the FDIC; rather, the Langleys assert fraudulent and knowing misrepresentations by a bank officer induced them to sign a promissory note, making the entire transaction invalid from its inception. Therefore, the Langleys' fraud claims are not barred by the statutory langauge of § 1823(e) and the FDIC is not entitled to a summary judgment on the basis of § 1823(e).

Federal common law provides no solace for the FDIC. The fashioning of federal common law is appropriate only where Congress has failed to enact a statutory rule. Congress has acted through the passage of 12 U.S.C. 1823(e) and a resort to federal common law is inappropriate.

For these reasons, the summary judgment in favor of the FDIC must be reversed and this matter remanded to the District Court for further proceedings.

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BY: _____
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PROOF OF SERVICE

I, William C. Shockey, a member of the bar of this Court, certify that pursuant to Rule 28 of this Court, I have served three (3) copies of the Brief for Petitioners on the Merits on respective counsel for the Respondent by enclosing a copy thereof in an envelope, first class postage prepaid properly addressed to:

1.) Mr. Charles Fried,
Solicitor General
Department of Justice
Washington, D.C. 20530

2.) John C. Murphy, Jr.
Ann S. DuRoss
Lawrence F. Bates
Jane Rossowski
Federal Deposit Insurance Corporation
Washington, D.C. 20429

and I deposited same in the United States mail at Baton Rouge, Louisiana, on the ____ day of March, 1987.

WILLIAM C. SHOCKEY